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LABOR RELATIONS AND LABOR LAW IN JAPAN

Atsushi Tsuneki and Manabu Matsunaka[†]

Abstract: This article builds on a rationalistic understanding of Japanese employment customs to argue that, up until the 1990s, Japanese labor law facilitated private bargaining instead of engineering a desired outcome directly through legal regulations. Through this indirect approach toward labor relations, at least part of Japanese labor law made a highly positive contribution to the attainment of economic efficiency. After the 1990s, the merits of Japanese employment customs diminished and needed reform. While such reforms were made in some aspects, Japanese labor law has taken the stance of directly regulating the economy, particularly in the area of employment protection and working hours regulation at this stage. Due to this mismatched regulatory approach toward Japanese employment relations, Japanese labor law has hindered the performance of the Japanese economy.

I. INTRODUCTION

This article argues that Japanese employment customs developed naturally through an agreement among the members of the Japanese employment system, and attained efficient economic performance up until the 1990s. During that time, Japanese labor law mainly worked toward facilitating private bargaining instead of engineering the desired result directly through legal regulations. Through this indirect approach toward labor relations, at least part of Japanese labor law made a highly positive contribution to the attainment of economic efficiency.

After the 1990s, when long run stagnation occurred in the Japanese economy, the merits of Japanese employment customs diminished and needed reform. At this stage, some aspects of Japanese labor law began to

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adopt a more market friendly approach to cope with this change. However, in some other important aspects, the law took the stance of directly regulating the economy, particularly in the area of employment protection and working hours. This approach was the exact opposite of the deregulation that was necessary to recover the efficiency of the Japanese economy after the 1990s. Due to this mismatched regulatory approach, Japanese labor law has hindered the performance of the Japanese economy.

The Japanese economy has provided economists with many puzzles. It possesses various apparently unique properties, such as the main bank system, mutual share holdings among group companies in the capital market, vertical relationship among firms (*keiretsu*),¹ and various interventions by the bureaucracy in the market economy.² A conspicuous example is the so-called Japanese employment custom, which is usually characterized by permanent employment and seniority.³

Although standard neo-classical economics may regard Japanese employment customs as a source of inefficiency counter to free competition in the labor market,⁴ this argument is unable to explain why post-war Japan succeeded economically at least until the 1980s.

Since the late 1980s, many economists have argued that a series of properties shown by the Japanese economy should be understood as a rational and efficient system that supported the economic success of post-war Japan.⁵ In the area of labor relations, Koike argues that the apparently

¹ For the nature and functions of the Japanese main bank system, see Masahiko Aoki, Hugh Patrick & Paul Sheard, *The Japanese Main Bank System: An Introductory Overview*, in *THE JAPANESE MAIN BANK SYSTEM* 3 (Masahiko Aoki & Hugh Patrick eds., 1994). For a summary of the characteristics of Japanese enterprises, including *keiretsu* and so-called Japanese employment system, see D. Eleanor Westney, *Japanese Enterprise Faces the Twenty-First Century*, in *THE TWENTY-FIRST-CENTURY FIRM: CHANGING ECONOMIC ORGANIZATION IN INTERNATIONAL PERSPECTIVE* 105, 106-35 (Paul DiMaggio ed., 2001).

² Basic observations on the Japanese industrial policy were surveyed in TAKATOSHI ITOH, *THE JAPANESE ECONOMY* 196-205 (1992). Recently, there have been discussions that cast doubt on the efficacy and even presence of systems that are said to be peculiar to Japan, including the main bank and bureaucracy led industrial policy. See, e.g., Yoshiro Miwa & J. Mark Ramseyer, *The Fable of Keiretsu*, 11 J. ECON. & MGMT. STRATEGY 169 (2002) (arguing that *keiretsu* has no substance and hence cannot be a characteristic of Japanese economy); Yoshiro Miwa & J. Mark Ramseyer, *Does Relationship Banking Matter?: The Myth of the Japanese Main Bank*, 2 J. EMPIRICAL LEGAL STUD. 261, 272-99 (2005) (arguing that none of the features of so called main bank system are empirically supported).

³ See, e.g., Kenichi Imai & Ryutaro Komiya, *Characteristics of Japanese Firms*, in *BUSINESS ENTERPRISE IN JAPAN: VIEWS OF LEADING JAPANESE ECONOMISTS* 19, 23 (Kenichi Imai & Ryutaro Komiya eds., 1994).

⁴ See, e.g., GEORGE J. BORJAS, *LABOR ECONOMICS* 163 (2d ed. 2000).

⁵ See, e.g., Masahiko Aoki, *Toward An Economic Model of the Japanese Firm*, 28 J. ECON. LITERATURE 1 (1990) (a survey of economic analysis of Japanese firms); *THE INDUSTRIAL POLICY OF JAPAN* (Ryūtarō Komiya, Masahiro Okuno & Kotarō Suzumura eds., Kazuo Satō trans., 1988) (providing an economic analysis of Japanese industrial policy).

group-oriented nature of Japanese labor relations and organizations can be naturally understood as a superior economic system in adjusting to an uncertain and changing economic environment.⁶ Some game-theoretic contributions argue that labor relations in both the United States and Japan can be characterized as two possibly efficient equilibria of the same game played by similarly rational players facing different institutional environments.⁷

Building on this rationalistic understanding of Japanese employment customs, this article discusses the relationship between Japanese labor law and employment customs. It addresses the question of whether Japanese labor law enforced the establishment of Japanese employment customs, or whether it adjusted itself to the already established system in the process of post-war economic development in Japan. This article simultaneously considers whether or not the Japanese labor law enhanced the efficiency of the system, both in the economic growth process until the 1980s and the stagnation period that began in the 1990s and has continued until now.

The remaining part of this article is organized as follows. Part II, of the article clarifies the contents of Japanese employment customs, referring to major empirical research, and presents the theoretical arguments that support the customs' economic rationality. Part III describes the historical outline of Japanese labor law, its basic principles, and the various aspects of Japanese labor law in general. Part IV.A. justifies our argument that Japanese labor law made highly positive contributions to the establishment of efficient Japanese labor relations. Part IV.B. discusses the rational adjustment of Japanese labor law to the structural change the Japanese economy underwent after the 1990s. Part IV.C. refers to the recent development of regulations in Japanese labor law. Part V summarizes the overall discussions and provides some remarks on the future of Japanese labor relations and labor law.

⁶ See KAZUO KOIKE, *THE ECONOMICS OF WORK IN JAPAN* 63-68 (1996).

⁷ See Masahiro Okuno-Fujiwara, *Monitoring Cost, Agency Relationship and Equilibrium Modes of Labor Contract*, 1 J. JAPANESE & INT'L ECON. 147 (1987); Yoshitsugu Kanemoto & W. Bentley MacLeod, *The Theory of Contracts and Labor Practices in Japan and the United States*, 12 MANAGERIAL & DECISION ECON. 159 (1991). See also MASAHIKO AOKI, *INFORMATION, INCENTIVES AND BARGAINING IN THE JAPANESE ECONOMY* 49 (1988) (providing an economic analysis of Japanese firms).

II. JAPANESE EMPLOYMENT CUSTOM: FACT AND THEORY

A. *Fact Findings*

The Japanese employment custom ("JEC") can be observed at least in some part, in the United States and Europe, particularly in certain large and established companies.⁸ Therefore, it is difficult to define the precise characteristics of Japanese employment customs that are unique to Japan.

However, several distinctive findings concerning the JEC have been reported for companies in Japan. First, a long-term employment relationship ("LTER") occurs more in Japan than other developed countries. The tendency for long-term employment exists in some European countries such as Germany or France, and even in the large United States companies.⁹ However, empirical research shows that on average, Japanese workers stay in the same firm for longer periods than American workers, and that the turnover rate of the former was lower.¹⁰

Second, in Japan, white-collar, and at least some blue-collar workers are embraced within the same system of long-term employment and career formation based on seniority and merit ratings.¹¹ They experience a wider range of mutually related jobs than workers in other countries. At the same time, job demarcation is more ambiguous. The delegation of *de facto* authority descends to the lower tiers of the production hierarchy, so that workers have a chance to utilize their first-hand knowledge in an attempt to improve the production system of their workplace.¹² The older skilled workers actively provide on-the-job training to the younger unskilled workers.¹³

⁸ See, e.g., KOIKE, *supra* note 6, at 40-41 (indicating that lifetime employment can be observed in the United States and in Western Europe); Westney, *supra* note 1, at 109 (discussing similarities and differences between Japan and other developed countries on employment systems including lifetime employment).

⁹ *Id.*

¹⁰ See Masanori Hashimoto & John Raisian, *Employment Tenure and Earnings Profiles in Japan and the United States*, 75 AM. ECON. REV. 721, 722-28 (1985). See also D.H. WHITTAKER, *MANAGING INNOVATION: A STUDY OF BRITISH AND JAPANESE FACTORIES* (1990) (providing a comparison between Japan and the United Kingdom).

¹¹ See KOIKE, *supra* note 6, at 34-41.

¹² See James R. Lincoln, Mitsuyo Hanada & Kerry McBride, *Organization Structures in Japanese and U.S. Manufacturing*, 31 ADMIN. SCI. Q. 338 (1986). See also James R. Lincoln & Kerry McBride, *Japanese Industrial Organization in Comparative Perspective*, 13 ANN. REV. SOCIOLOGY 289 (1987).

¹³ Therefore, labor contracts for regular (typical) workers in Japan do not include explicit agreements on job contents. See KOIKE, *supra* note 6, at 50-61, 66-72. In contrast, in the United States, labor contracts explicitly specify the kind of job and its performance standards. See PETER B. DOERINGER & MICHAEL J. PIORE, *INTERNAL LABOR MARKETS AND MANPOWER ANALYSIS* 42-56 (1971).

Third, the wage payment system is also common with white-collar and blue-collar workers.¹⁴ Wage is determined by seniority and promotion to the higher-ranking hierarchy, which depends on merit assessments, but wage level is only remotely related to job type.¹⁵ Most empirical research shows that merit assessments are more important than seniority in this process, and the lifetime earning differences among workers are rather large despite the appearance of egalitarianism.¹⁶ Some believe that seniority mattered more than merit in the Japanese system of remuneration. This mistake is based on the fact that the link between short-run performance and payment to workers is weak and the speed of worker promotion is slow. In reality, the difference of lifetime income among workers is high due to difference in speed of promotion.¹⁷ The speed depends on the assessment of merit by the central personnel department, which makes the department powerful.¹⁸

Although the features explained above in relation to Japanese firms broadly apply to white-collar workers in large companies in the United States and Europe, they are characteristics of Japan in that this system is extended to blue-collar workers.¹⁹

Fourth, labor unions are not industry-based unions as in the Western countries, but company-based ones.²⁰ The labor union has a long-term relationship with the employer and represents all workers of an enterprise, including both white-collar and blue-collar workers.²¹ The management of the firm is chiefly determined by inner promotion, and those selected for the

¹⁴ See KOIKE, *supra* note 6, at 26.

¹⁵ See Hashimoto & Raisian, *supra* note 10, at 728-32; Arne L. Kalleberg & James R. Lincoln, *The Structure of Earnings Inequality in the United States and Japan*, 94 AM. J. SOCIOLOGY S121, S140-S145 (1988).

¹⁶ See Toshiaki Tachibanaki, *The Determination of the Promotion Process in Organizations and of Earnings Differentials*, 8 J. ECON. BEHAV. & ORG. 603 (1987); Toshiaki Tachibanaki, *Education, Occupation, Hierarchy and Earnings*, 7 ECON. EDUC. REV. 221 (1988) (empirical research showing that promotion and associated increase of earnings differentials are more dependent on evaluation than seniority); Hiroyuki Fujimura, *Seiseki Satei no Kokusai Hikaku [International Comparison of Merit Ratings]*, 362 NIHON RÔDÔ KYÔKAI ZASSHI 26 (1989) (showing that wage increase is rather inelastic to seniority).

¹⁷ See, e.g., Andrew Weiss, *Simple Truths of Japanese Manufacturing*, HARV. BUS. REV., Jul.-Aug. 1984, at 119.

¹⁸ These features are also pointed out as part of common structures of the Japanese employment system. See, e.g., John O. Haley, *Heisei Renewal or Heisei Transformation: Are Legal Reforms Really Changing Japan?*, 19 J. JAPAN L. 5, 15 (2005).

¹⁹ See KOIKE, *supra* note 6, at 13-27.

²⁰ See ITO, *supra* note 2, at 226; TAKASHI ARAKI, *LABOR AND EMPLOYMENT LAW IN JAPAN* 164-65 (2002).

²¹ See KOIKE, *supra* note 6, at 212-16.

management usually have some experience in labor union activities.²² Therefore, management and labor are more likely to have common interests, and the labor union has indirect power to influence the management decisions through discussions between labor and management.²³

Fifth, there are many non-regular workers (atypical workers) such as part-time workers and dispatched workers that are differentiated from regular workers in promotion, payment, and employment guarantee.²⁴ Therefore, the Japanese labor market has a dual nature, wherein the part of the market that consists of regular workers is internalized within the firm, while non-regular workers participate in an outside spot market and engage in more frequent career turnovers. Note that this dual nature is universally observed in developed capitalist countries.²⁵ However, it is characteristic of the Japanese economy to clearly distinguish regular and non-regular workers at the time of hiring.²⁶

These five properties depict the group-oriented nature of the JEC, which some argue arises from the group-oriented culture of Japan.²⁷ Also, some scholars have explained JEC by using cultural or comparative-sociological approaches such as *amae* (dependence) or Confucianism where the nature of the JEC is attributed to the mentality or spiritual tradition inherent in Japan.²⁸ However, these culture-based explanations of Japanese industrial relations are inconclusive because elements of the JEC exist in all developed capitalist countries.

The cultural theories are also questionable from a historical point of view. The customs discussed did not exist from the beginning of the

²² See, e.g., Hiroyuki Fujimura, *Keieisha no Kyaria to Hōshū no Jittai* [The State of the Career and Payment of Managers], in GENDAI NIHON NO KŌPORĒTO GABANANSU [CORPORATE GOVERNANCE IN MODERN JAPAN] 135, 145-47 (Takeshi Inagami & Rengō Sōgō Seikatsu Kaihatsu Kenkyūsho eds., 2000).

²³ See KOIKE, *supra* note 6, at 195-216 (a detailed international comparison of the functions of the labor union and its performance evaluations).

²⁴ Recently the percentage of these atypical workers has been increasing, particularly in the service sector. See, e.g., Ryūichi Yamakawa, *Labor Law Reform in Japan: A Response to Recent Socio-Economic Changes*, 49 AM. J. COMP. L. 627, 628-29 (2001).

²⁵ See DOERINGER & PIORE, *supra* note 13, at 164-83 (discussing the existence and economic implications of the dual labor market in the United States).

²⁶ See Yamakawa, *supra* note 24, at 629.

²⁷ See, e.g., JAMES C. ABEGGLEN & GEORGE STALK JR., KAISHA: THE JAPANESE CORPORATION 198-99 (1985).

²⁸ See, e.g., *id.* at 198; RONALD DORE, TAKING JAPAN SERIOUSLY (1987) (stressing the contribution of Confucianism to the Japanese system of enterprise and society); MICHIO MORISHIMA, WHY HAS JAPAN SUCCEEDED? WESTERN TECHNOLOGY AND THE JAPANESE ETHOS (1982) (analyzing the effect of Confucianism adapted to Japan on the economic development of Japan since the Meiji Restoration). For the brief summary of the cultural theory of Japanese industrial relations, see MARCUS REBICK, THE JAPANESE EMPLOYMENT SYSTEM: ADAPTING TO A NEW ECONOMIC ENVIRONMENT 17-18 (2005).

Japanese economy.²⁹ Broad economic regulations to reinforce a planned economy during World War II formed the basis of JEC and were maintained through a democratization program by the Allied High Command that strengthened the position of laborers during the occupation era.³⁰ Japanese management retained this method from Japan's high growth period until the 1980s. Before the 1940s, the Japanese economy had a classical market system with a competitive labor market that facilitated the highly frequent turnover of workers. The possibility of permanent employment and participation of labor in management was very limited, and labor unions were industry-based, not enterprise-based unions, as observed in other developed countries.³¹

B. *Appraisal from the Theoretical Point of View*

The JEC is usually characterized by its egalitarianism based on the LTER and the seniority system in place with respect to promotion and remuneration.³² However, in reality, the process of promotion and remuneration is far more meritocratic than it appears, based on the assessments of the employer. In addition, on-the-job training ("OJT") activity is linked to the process of frequent rotations to accumulate workers' firm specific human capital.³³

Production systems do not only deal with routine work, even if it appears to be a highly technological process that should be optimized with respect to engineering methods.³⁴ There are always uncertain accidents, demand shocks, or technological innovations that require adjustments in the production system. Human capital and termed intellectual skills become

²⁹ See, e.g., Tetsuji Okazaki, *The Japanese Firm Under the Wartime Planned Economy*, in THE JAPANESE FIRM: THE SOURCES OF COMPETITIVE STRENGTH 350, 357-59 (Masahiko Aoki & Ronald Dore eds., 1994) (empirically showing that lifetime employment was not prevalent in prewar Japan compared to postwar).

³⁰ See, e.g., *id.* at 369-70; WILLIAM B. GOULD, JAPAN'S RESHAPING OF AMERICAN LABOR LAW 17-43 (1984). Fierce confrontation between labor and management in the post war period ended and the relationship between them largely turned into cooperative one. See generally ANDREW GORDON, THE WAGES OF AFFLUENCE: LABOR AND MANAGEMENT IN POSTWAR JAPAN (1998).

³¹ See generally Walter Galenson & Konosuke Odaka, *The Japanese Labor Market*, in ASIA'S NEW GIANT: HOW THE JAPANESE ECONOMY WORKS 587, 614-16 (Hugh Patrick & Henry Rosovsky eds., 1976) (detailing the labor market situation in Japan before the 1940s). See also ANDREW GORDON, THE EVOLUTION OF LABOR RELATIONS IN JAPAN (1985) (survey on the historical development of Japanese labor relations).

³² See, e.g., ITOH, *supra* note 2, at 210-13 (summarizing this conventional wisdom for Japanese industrial relations).

³³ See KOIKE, *supra* note 6, at 54-60 (explaining OJT and job rotations of Japanese firms in detail).

³⁴ See *id.* at 63.

necessary to deal with this problem.³⁵ Japanese OJT requires workers to train in a broad class of jobs thereby encouraging the development of this type of knowledge.³⁶

Such a system succeeds only when workers are offered incentives for making efforts to accumulate strictly firm-specific intellectual skills including the willingness to rotate among various types of jobs depending on the economic environment or the process of OJT, and the willingness of senior workers to accept and train young workers on the job. According to the classical human capital theory, a competitive labor market does not ensure an efficient level of investment in firm-specific human capital.³⁷ Owing to the firm-specific nature, firms do not have an incentive to pay for workers' investment effort, and given this expectation, workers lose their incentive to invest. Even explicit contractual arrangements cannot solve the problem due to the problem of third-party verifiability.³⁸ As courts cannot observe the level of human capital investment, a worker will not invest if he is paid prior to investment: further, he will be less motivated to invest as he cannot rely on a firm's promise to pay later for the same reason of verifiability.

To solve this problem, it is necessary to provide incentives for workers to invest and for firms to pay appropriately for the workers' efforts: i.e. the LTER should be a self-enforcing implicit contract that does not involve verifiability problems. Several features of the JEC listed in the previous section can be understood as a system to provide incentives for workers to invest in human capital.

One important trait of the Japanese LTER is that wages are not observably elastic to observable measure in the short term. Namely, under the LTER most of the wages are not related to performance indices such as output, sales, or profits. At first glance linking wages to those indices seems to stimulate worker efforts. But there is a large shortcoming in that such wages encourage workers to improve only their short-run performance, without being interested in the accumulation of intellectual skills that are

³⁵ See *id.* at 63-68.

³⁶ See *id.* at 68-72, 241-59.

³⁷ See, e.g., Jacob Mincer, *Investment in Human Capital and Personal Income Distribution*, 66 J. POL. ECON. 281 (1958); Jacob Mincer, *On-the-Job Training: Costs, Returns and Some Implications*, 70 J. POL. ECON. 50 (1962); GARY S. BECKER, *HUMAN CAPITAL: A THEORETICAL AND EMPIRICAL ANALYSIS, WITH SPECIAL REFERENCE TO EDUCATION* (2d ed. 1975).

³⁸ This is a basic problem dealt with by the incomplete contract theory. See Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755 (1988).

useful in the long-run.³⁹ In addition, incentive pay does not work when the observable performance measures that are linked to the compensation do not completely reflect the efforts of workers and the direct monitoring of workers is not very expensive. These two conditions apply to Japanese organizations in which the group production system is developed and in which the management is more concerned with long-term efficiency. These are the main reasons that this type of short-run incentive pay has not prevailed in Japan.⁴⁰

Under the JEC, companies provide the incentive to work hard and train through the promotion process and the associated increase in wages that occurs in the long run. As explained in the previous section, merit assessment matters more than seniority, and the lifetime earning differences among workers are considerably large.⁴¹ This process can be interpreted as a type of tournament wherein firms are committed to the lifetime employment of workers and their appropriate remuneration.⁴²

Unfortunately, this system has a disadvantage in that it may protect against the moral hazard that firms renege on the wage payment to workers who do make sufficient efforts. As the amount of effort and wage which should be paid for that effort cannot be completely verified, the firm has an incentive to cut the wages of workers, although their job performance and accumulation of firm specific human capital are sufficient. Owing to this absence of credibility, workers are not willing to invest in human capital, and the LTER fails.

To rectify this disadvantage, this implicit contract should be enforced through the bargaining between the employer and the labor union. Here,

³⁹ See Hideshi Itoh, *Japanese Human Resource Management from the Viewpoint of Incentive Theory*, in *THE JAPANESE FIRM: THE SOURCES OF COMPETITIVE STRENGTH* 233, 240-57 (Masahiko Aoki & Ronald Dore eds., 1994) (arguing that the Japanese system of human resource allocation and remuneration is both rational and efficient).

⁴⁰ In other developed countries such as the United States, it is also known that the remuneration system is not very elastic to the short-run performance indices, at least for large companies and with the exception of executive compensation, although this tendency is not as conspicuous as in the case of Japan. However, they adopt a different system of remuneration from Japan in that wages are directly attached to jobs instead of individuals. See DOERINGER & PIORE, *supra* note 13, at 65-71. This system of wages determined by the type and difficulty of jobs also works as a strong incentive device to increase workers' efforts, since this system works as a tournament among workers for the limited number of good positions. For a theoretical analysis of this type of economy, see Lorne Carmichael, *Firm-Specific Human Capital and Promotion Ladders*, 14 *BELL J. ECON.* 251 (1983); James M. Malcomson, *Work Incentives, Hierarchy, and Internal Labor Markets*, 92 *J. POL. ECON.* 486 (1984); W. Bentley MacLeod & James M. Malcomson, *Reputation and Hierarchy in Dynamic Models of Employment*, 96 *J. POL. ECON.* 832 (1988).

⁴¹ See *supra* note 16 and accompanying text.

⁴² See Kanemoto & MacLeod, *supra* note 7; Yoshitsugu Kanemoto & W. Bentley MacLeod, *Firm Reputation and Self-Enforcing Labor Contracts*, 6 *J. JAPANESE & INT'L ECON.* 144 (1992).

employers must keep their promise of remuneration in order to protect their reputation because they fear that labor unions will retaliate in the future by not cooperating with the management.⁴³ For example, they might go on a strike or bargain for a higher wage increase or better working conditions in the following year's negotiations.

C. *Interpretation of JEC and Some Other Implications Derived from Economic Theory*

The theoretical analysis in Part II.B. makes the rationalistic interpretation of JEC possible. Long-term employment and seniority wages are devices to provide incentives to workers for the efficient accumulation of firm-specific skills,⁴⁴ and ambiguous job demarcation and the delegation of authorities to the lower tiers of production hierarchies are mechanisms for facilitating the use of firm-specific skills for the improvement of the production system.⁴⁵ The intra-firm labor union is used for the communication between labor and management, and the negotiation in the intra-firm is more important than an industry-wide problem.⁴⁶ The dual nature of the Japanese labor market can be naturally understood as the returns provided to the regular workers for their extra effort in investment into the firm-specific human capital, which was not necessary for non-regular workers.

To explain why certain efficient traits that characterize the Japanese LTER are observed in the Western countries, but only for white-collar workers in large firms, it is necessary to consider the conditions necessary for the bargaining process between labor and management to perform effectively. The coordination of expectations between two players is necessary for attaining an efficient reputation equilibrium.⁴⁷ More concretely, firms should build a reputation that they keep their promises with workers.

⁴³ See Kanemoto & MacLeod, *supra* note 42 (applying the reputation effect to the analysis of Japanese firms). The reputation effect was first put into economic analysis by Klein and Leffler. Benjamin Klein & Keith B. Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981).

⁴⁴ See *supra* notes 41-42 and accompanying text.

⁴⁵ See *supra* notes 34-40 and accompanying text.

⁴⁶ See *supra* note 43 and accompanying text.

⁴⁷ For a general discussion of this issue, see David G. Pearce, *Repeated Games: Cooperation and Rationality*, in *ADVANCES IN ECONOMIC THEORY: SIXTH WORLD CONGRESS* 132 (Jean-Jacques Laffont ed., 1992); DREW FUDENBERG & JEAN TIROLE, *GAME THEORY* 145-200 (1991).

This observation seems to imply that the Japanese system of employment can only be introduced for the class of workers that is relatively protected against the business cycle or technical innovations, since it is for this type of workers that firms can keep promises regarding remuneration for long time and their words become credible. It is exactly this class of workers that are white-collar in large companies.⁴⁸

This theoretical argument further provides some insight on the relative decline in the effectiveness of the JEC. The world economy after the 1990s is partly characterized by drastic technological progress, led mainly by the development of information technology and financial engineering.⁴⁹ When new businesses and industries came into existence, old technologies became obsolete within a short span of time. As the merit of JEC lies in the accumulation of firm-specific knowledge in the long run, it is more effective in an economic environment growing at a stable rate and with relatively small technical changes. Japan needs a new system of labor relations and labor market to cope with this change.⁵⁰

III. STRUCTURE OF JAPANESE LABOR LAW

A. *Historical Origin*

Japanese labor law was not sufficiently developed before World War II. There were several laws that regulated individual labor relations, such as protecting minor or female laborers, determining minimum safety standards, and number of working hours.⁵¹ There were also laws for regulating employment agencies and the requirement of workers' accident compensation insurance.⁵² In addition, during wartime some laws were enacted to control minimum wage⁵³ and work time.⁵⁴ These laws formed the

⁴⁸ If firms in other countries do not have a good reputation, workers will strongly oppose the introduction of the Japanese system of management, which gives more discretionary power to the employers. See Kanemoto & MacLeod, *supra* note 42, at 146.

⁴⁹ See REBICK, *supra* note 28, at 41-42 (discussing this technical change and its effect on the career patterns of standard employees in Japan). For the effect of technical changes on the labor market, see *infra* note 167 and accompanying text.

⁵⁰ See, e.g., *id.* at 32.

⁵¹ Kōjōhō, [Factory Law], Law No. 46 of 1911; Kōjōhō Shikōrei [Ordinance for Enforcement of Factory Law], Imperial Ordinance No. 193 of 1916. These were repealed when the Labor Standards Law (Rōdō Kijūnhō) was enacted in 1947.

⁵² Rōdōsha Saigai Fūjōhō [Worker's Injury Assistance Law], Law No. 54 of 1931; Rōdōsha Saigai Fūjo Hokenhō [Worker's Injury Assistance Insurance Law], Law No. 54 of 1931.

⁵³ Chingin Tōseirei [Wage Control Ordinance], Imperial Ordinance No. 128 of 1937.

⁵⁴ Kōjō Shūgyō Jikanrei [Factory Employment Hours Ordinance], Imperial Ordinance No. 127 of 1937.

basis of the enactment of the post-World-War-II laws, but they were limited compared to today's standards. Furthermore, labor movements were repressed under criminal law, and efforts to legislate labor unions failed until the end of the war.⁵⁵

The situation changed drastically after the war. The Allied High Command promoted a social policy for protecting workers and their labor union activities as a part of its democratization program toward Japan. The Labor Union Law was enacted in 1945⁵⁶ and it was revised in 1949 to its present form.⁵⁷ At the same time, the union density (rate of the union membership among workers) exceeded 50%.⁵⁸

In addition, there were changes in the area of individual labor relations. The New Constitution of 1946 established the basic right to work, defined the principles for the legislation on labor conditions,⁵⁹ and guaranteed the right to organize and bargain and act collectively.⁶⁰ In 1947, the Labor Standards Law⁶¹ and the Workers' Accident Compensation Law⁶² were promulgated, raising the level of worker protection to International Labour Standards of the International Labour Organization ("ILO"). Further, the basic laws on unemployment were promulgated during this period.⁶³ This basic framework of the Japanese labor law was constructed between 1945 and 1955 and survives even today.⁶⁴

B. Basic Principles

For labor contracts, as with other contracts, there is freedom of contract and consequently the contract between a worker and an employer is

⁵⁵ See KAZUO SUGENO, JAPANESE EMPLOYMENT AND LABOR LAW 5-8 (Leo Kanowitz trans., 2002).

⁵⁶ Rōdō Kumiai-hō [Labor Union Law], Law No. 51 of 1945.

⁵⁷ Rōdō Kumiai-hō [Labor Union Law], Law No. 174 of 1949. For a brief summary of the formation and amendment of the Labor Union Law in English, see Tetsunari Doko, *The Labor Relations Commission as an Organization to Resolve Collective Labor Disputes*, 3(1) JAPAN LABOR REV. 32, 32-35 (2006).

⁵⁸ KŌSEI RŌDŌSHŌ [MINISTRY OF HEALTH, LABOUR AND WELFARE], RŌDŌKUMIAI KISO CHŌSA JIKIRETSUHYŌ DAI 1 HYŌ [BASIC SURVEY ON LABOR UNION TABLE 1] (2006) (indicating that in 1947 the union density rate had been 45.3% and it increased to 53.0% in the next year. In 1949, the year in which present Labor Union Law was promulgated, the rate rose to 55.8%).

⁵⁹ See NIHONKOKU KENPŌ [KENPŌ] [CONSTITUTION], art. 27 (providing that working standards, including wages and rest time, shall be established by law).

⁶⁰ See *id.* at art. 28.

⁶¹ Rōdō Kijun-hō [Labor Standards Law], Law No. 49 of 1947.

⁶² Rōdōsha Saigai Hoshō Hoken-hō [Workers' Accident Compensation Law], Law No. 50 of 1947.

⁶³ To cope with unemployment caused by deflationary policies under Dodge Line, Unemployment Insurance Law was amended and Emergency Countermeasures Law was enacted. See SUGENO, *supra* note 55, at 9-10. For details of situation of employment in these days, see RŌDŌSHŌ [MINISTRY OF LABOUR], SHOWA 24 NEN RŌDŌ KEIZAI NO BUNSEKI [ANALYSIS OF LABOR ECONOMICS 1947] ch. 2 (1947).

⁶⁴ See SUGENO, *supra* note 55, at 8-10.

enforceable.⁶⁵ In reality, this is not so free as it may first appear. It is commonly explained as follows. Since the bargaining power between individual workers and employers is extremely unequal without any regulations, labor contracts can be rather unfair and unreasonable in determining the terms of working conditions.⁶⁶ Hence labor laws empower workers in many ways in order to facilitate the fairness of the terms of labor contracts.⁶⁷

Japanese labor law supports laborers in three ways. First, it provides compulsory minimum standards for working conditions such as wages,⁶⁸ working hours,⁶⁹ and safety.⁷⁰ Second, to facilitate equal bargaining between labor and management, it guarantees workers the right to bargain collectively by forming unions.⁷¹ Third, to improve the labor market mechanism, information and employment placement service is provided by public employment agencies,⁷² and those seeking employment can receive subsidies, which includes unemployment benefits.⁷³

There are also regulations against discriminatory treatments. Once hired, employers may not discriminate against employees for factors such as race, sex, or ideology.⁷⁴ While discriminatory treatment in general is

⁶⁵ Freedom of contract is a basic principle of Civil Law. Without laws modifying or restricting this freedom, contracting parties are free to agree upon whatever provisions they want and it will be enforceable, as long as it is not against public policy. See MINPŌ [CIV. C.], art. 90 (providing that contracts and other acts should be nullified if against public policy). Labor laws function as a restriction on this freedom.

⁶⁶ See SUGENO, *supra* note 55, at 76.

⁶⁷ See *id.*

⁶⁸ See Saitei Chinginhō [Minimum Wage Law], Law No. 137 of 1959, art. 5, paras. 1, 2. For details, see *infra* note 122 and accompanying text.

⁶⁹ See Rōdō Kijunhō [Labor Standards Law], Law No. 49 of 1947, art. 32, paras. 1, 2.

⁷⁰ See *id.* at art. 42; Rōdō Anzen Eiseihō [Labor Safety and Health Law], Law No. 57 of 1982.

⁷¹ See NIHONKOKU KENPŌ [KENPŌ] [CONSTITUTION], art. 28. Rights and privileges of labor unions and duties of employers are provided in the Labor Union Law (*Rōdō Kumiai-hō*). For example, the law provides an exemption from criminal punishment for actions in appropriate strikes. Rōdō Kumiai-hō [Labor Union Law], Law No. 174 of 1949, art. 1, para. 2. See also KEIHŌ [PENAL CODE], art. 35.

⁷² See Shokugyō Antei-hō [Employment Security Law], Law No. 141 of 1947, art. 5. Until 1999, private employment placement service was strictly restricted to only few jobs, and employment placement services were generally provided by governmental agencies. In the 1999 amendments to the Employment Security Law and Worker's Dispatching Law, this regulation was largely changed to liberalize restrictions on private employment placement services and to remove governmental monopolization. See also Takashi Araki, *1999 Revisions of Employment Security Law and Worker Dispatching Law: Drastic Reforms of Japanese Labor Market Regulations*, 38 (9) JAPAN LABOR BULLETIN 5-12 (1999); Yamakawa, *supra* note 24, at 642.

⁷³ See generally Koyō Hokenhō [Employment Insurance Law], Law No. 116 of 1974; Rōdō Hoken no Hokenryō no Chōshūtō ni Kansuru Hōritsu [Law Concerning Collection of Labor Insurance Premium], Law No. 84 of 1973.

⁷⁴ See Rōdō Kijunhō [Labor Standards Law], Law No. 49 of 1947, arts. 3, 4 (prohibiting discriminatory treatment of employees in general); Koyō no Bunya ni Okeru Danjo no Kintōna Kikai

explicitly prohibited only after workers are hired (discrimination at the stage of recruitment and hiring is not explicitly restricted), sex discrimination at the stage of recruitment and hiring of employees, such as excluding females from recruitment,⁷⁵ is severely prohibited by the Equal Employment Opportunity Law.⁷⁶ It has long been argued that Japanese female workers are discriminated against in the recruitment process and in their treatment within the firm, making them unable to hold regular positions in the LTER.⁷⁷ To rectify this situation, the Equal Employment Opportunity Law⁷⁸ was enacted in 1985 and developed to its present form in 1997.⁷⁹

C. *The Long-Term Employment Relationship and the Protection of Employment*

Part II.A. pointed out the fact that the LTER has prevailed in the above-middle sized Japanese companies and the features of it. Due to the self-enforcing nature of LTER, a considerable part of the working conditions is not explicitly written in individual contracts.⁸⁰ Therefore, work rules

Oyobi Taigū no Kakuho ni Kansuru Hōritsu [Equal Employment Opportunity Law], Law No. 113 of 1972, arts. 5-9 (prohibiting discrimination by gender).

⁷⁵ See Rōdōsha ni Taisuru Seibetsu wo Riyū to Suru Sabetsu no Kinshitō ni Kansuru Kitei ni Sadameru Jikō ni Kanshi, Jigyōnushi ga Tekisetsu ni Taisho Suru Tame no Shishin [Guidelines on Appropriate Measures Employers Should Take Concerning Provisions Prohibiting the Sexual Discrimination of Workers], 2006 ROKOKU 164, art. 2, para. 2, item 2.

⁷⁶ Koyō no Bunya ni Okeru Danjo no Kintōna Kikai Oyobi Taigū no Kakuho ni Kansuru Hōritsu [Equal Employment Opportunity Law], Law No. 113 of 1972, art. 5. Employers only had duty to make efforts to provide women with opportunities equal to men until the 1997 amendments of the Equal Employment Opportunity Law. For the 1997 amendments, see Yamakawa, *supra* note 24, at 636-40.

⁷⁷ This difficulty can be explained by using the statistical theory of discrimination. See Edmund Phelps, *The Statistical Theory of Racism and Sexism*, 62 AM. ECON. REV. 659 (1972); Joseph E. Stiglitz, *Approaches to the Economics of Discrimination*, 63 AM. ECON. REV. 287 (1973).

⁷⁸ Koyō no Bunya ni Okeru Danjo no Kintōna Kikai Oyobi Taigū no Kakuho ni Kansuru Hōritsu [Equal Employment Opportunity Law], Law No. 113 of 1972.

⁷⁹ See ARAKI, *supra* note 20, at 108-22. There has been a steady increase in the share of females holding permanent positions in Japanese firms since 1975. See REBICK, *supra* note 28, at 113-18, tbl. 7.2.

⁸⁰ See *infra* Part III.D. Fixed-term labor contracts are severely restricted in Japan. Before the 1998 amendment, article 14 of Labor Standards Law in principle prohibited fixed-term labor contracts that last longer than one year. See Hiroya Nakakubo, *The 2003 Revision of the Labor Standards Law: Fixed-Term Contracts, Dismissal and Discretionary-Work Schemes*, 2(1) JAPAN LABOR REV. 4, 7 (2004). This restriction was said to protect workers from being bound too long and therefore being deprived of their freedom to resignation. See SUGENO, *supra* note 55, at 188-91. Since this restriction can be circumvented easily and the fear of obligatory servitude has become obsolete, this restriction has been gradually liberalized. See Takashi Araki, *Changing Employment Practices, Corporate Governance, and the Role of Labor Law in Japan*, 28 COMP. LABOR L. & POL'Y J. 251, 276-77 (2007). The 1998 amendment made certain exceptions, for certain types of labor contracts, such as scientific research, the maximum period may be three years. See Yamakawa, *supra* note 24, at 632. Further, under the 2003 amendment, the maximum period for all types of labor contracts became three years. Also, for certain types of contracts, the maximum period was extended from three years to five years. See KŌSEI RŌDŌSHŌ [MINISTRY OF

(*shūgyō kisoku*) and collective agreements among union(s) and employer (*rōdō kyōyaku*) become important since they have a function of filling the gaps.

The LTER is a type of labor contract without a fixed term and is legally different from a series of contracts that are renegotiated and updated every few years.⁸¹ Under the Civil Code, both employers and employees can terminate this type of labor contract at will with two weeks' notice.⁸² Under this rule, employers have the freedom to dismiss employees, and workers have the freedom to resign. The Labor Standards Law traditionally provided few explicit restrictions on dismissal.⁸³

However, this freedom of dismissal has been strictly restricted under the doctrine of abusive dismissal that has been formed by case law and later codified in the statutes. Under the doctrine, employers can dismiss workers only when there are reasonable and objective grounds to do so.⁸⁴ For example, a dismissal based simply on the subjective sentiment of the employer is not allowed under this principle.

When the decision of dismissal is judged illegal, the employer is compelled to continue the employment relationship.⁸⁵ Moreover, because the labor contract relationship continues during the period between the invalid dismissal and the judgment voiding the dismissal, workers can claim the wages for this period.⁸⁶

The doctrine, originally developed in cases of disciplinary dismissals, was extended to the cases of adjustment dismissals during the recession, particularly after the 1973 Oil Shock.⁸⁷ This was the time when the Japanese

HEALTH, LABOUR AND WELFARE], KAISEI RŌDŌ KIJUNHŌ NO GAIYŌ [SUMMARY OF AMENDED LABOR STANDARDS LAW] 2 (2003), <http://www.mhlw.go.jp/topics/2003/11/dl/tp11111-1a.pdf>.

⁸¹ See Rōdō Kijunhō [Labor Standards Law], Law No. 49 of 1947, art. 14, para. 1.

⁸² MINPŌ [CIV. C.] art. 627, para. 1.

⁸³ E.g., Rōdō Kijunhō [Labor Standards Law], Law No. 49 of 1947, art. 19 (prohibiting dismissal during periods of leave by maternity or by injury or illness caused by work). See SUGENO, *supra* note 55, at 474.

⁸⁴ See, e.g., Saikō Saibansho [Sup. Ct.], Apr. 25, 1975, 29 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 456, 457 (Japan); Saikō Saibansho [Sup. Ct.], Jan. 31, 1977, 268 RŌDŌ HANREI 17, 18 (Japan).

⁸⁵ See Rōdō Keiyakuhō [Employment Contract Law], Law No. 128 of 2007, art. 16. This does not always mean that employers will actually put the abusively dismissed worker in the position the worker had assumed before. Rather, it protects workers because the employer must pay wages as long as the labor contract is in effect. See Ryūichi Yamakawa, *Nihon no Kaikohōsei [Japanese Law of Dismissal]*, in KAIKOHŌSEI WO KANGAERU [EXAMINING LAW OF DISMISSAL] 3, 8 (Fumio Ōtake et al. eds., 2002). In sum, this provides bargaining power to workers since employers will pay some extra compensation to workers who resign voluntarily.

⁸⁶ See SUGENO, *supra* note 55, at 482-83.

⁸⁷ See, e.g., Tōkyō Kōtō Saibansho [Tōkyō High Ct.] Oct. 29, 1979, 330 RŌDŌ HANREI 71, 78-79 (Japan) (indicating that the doctrine of abusive dismissal rights is applied to the cases of adjustment

custom of employment adjustment was firmly established. At least in the large companies in Japan, dismissal was avoided by restricting overtime work, suspending mid-career hiring, transferring and farming out workers to related companies, terminating the employment of non-regular workers, and soliciting voluntary retirement by old workers.⁸⁸ Dismissing typical workers was not regarded as the first option employers should take in recessions.

The Doctrine of Abusive Dismissal requires the four conditions below in the case of adjustment dismissal:⁸⁹

- (1) the urgent necessity of dismissal for the survival of the firm,
- (2) fulfillment of duty of efforts to avoid dismissal,
- (3) propriety of the selection criteria for the dismissed,
- (4) procedural reasonableness.

Condition (1) is the presupposition for adjustment dismissal.⁹⁰ In judging condition (1), Japanese courts have taken a view that adjustment dismissal should be reasonable means to resolve present or future deficits.⁹¹ As mentioned above, even when there are deficits, courts held that adjustment dismissal was only a solution if reasonable efforts to avoid dismissal were taken.⁹² Thus, in the court's view, employers should first search for a way to avoid adjustment dismissal.⁹³ With regard to condition (3), if there are no objective standards for the selection or if the standards are deemed objectively unreasonable, the adjustment dismissal will be void.⁹⁴ Condition (4) virtually implies the duty to explain and consult with the labor

dismissals); Saikō Saibansho [Sup. Ct.] Oct. 27, 1983, 427 RŌDŌ HANREI 63, 64. See also Yamakawa, *supra* note 85, at 8-9.

⁸⁸ Courts recognize that workers normally expect continual employment and firms employ workers on the premise that workers would expect so. See, e.g., Fukuoka Kōtō Saibansho [Fukuoka High Ct.], Oct. 24, 1979, 427 RŌDŌ HANREI 64, 65-66 (Japan); Tōkyō Kōtō Saibansho [Tōkyō High Ct.] Mar. 31, 1993, 629 RŌDŌ HANREI 19, 23 (Japan).

⁸⁹ See, e.g., Tōkyō Kōtō Saibansho [Tōkyō High Ct.] Oct. 29, 1979, 330 RŌDŌ HANREI at 78-79. See also SUGENO, *supra* note 55, at 487-89.

⁹⁰ See, e.g., Ōsaka Chihō Saibansho [Ōsaka Dist. Ct.], May 8, 2000, 787 RŌDŌ HANREI 18, 27 (Japan) (indicating that necessity for adjustment dismissal had decreased and invalidated the dismissal).

⁹¹ See, e.g., Tōkyō Kōtō Saibansho [Tōkyō High Ct.] Oct. 29, 1979, 330 RŌDŌ HANREI at 78-79.

⁹² See, e.g., *id.* at 78; Fukuoka Kōtō Saibansho [Fukuoka High Ct.], Oct. 24, 1979, 427 RŌDŌ HANREI at 64; Ōsaka Chihō Saibansho [Ōsaka Dist. Ct.], May 8, 2000, 787 RŌDŌ HANREI at 28.

⁹³ But this does not mean that employers should test literally all available means before dismissing workers for adjustment. See, e.g., Tōkyō Kōtō Saibansho [Tōkyō High Ct.], July 23, 1999, 775 RŌDŌ HANREI 71, 80-81 (Japan) (rejecting the argument of plaintiff workers that defendant firm could have taken means other than adjustment dismissal such as work sharing on the ground that those means did not seem to function well in the defendant corporation).

⁹⁴ See SUGENO, *supra* note 55, at 489.

union in good faith, and is consistent with the method of employment adjustment of Japanese firms stated above.⁹⁵

When the disputed dismissal is judged as being void, the employer must pay the wages for the period in which the worker was dismissed.⁹⁶ Contrary to European countries, the option to end the employment relationship without the agreement of the worker, but in exchange for the payment of some compensation when the dismissal is judged as void, is not permissible in Japan.⁹⁷

The doctrine has its foundation in the basic principle of Civil Law that prohibits the abusive exercise of rights.⁹⁸ Lower courts began to utilize the principle for solving dismissal cases during and after 1973 Oil Shock.⁹⁹ In the late 1970s, the Supreme Court finally endorsed the doctrine.¹⁰⁰ In 2003 the doctrine was codified in the Labor Standards Law,¹⁰¹ and the provision has been moved into new Employment Contract Law that came into force on March 2008.¹⁰²

D. *The Long-Term Employment Relationship as Relational Contract*

The LTER is also incomplete in terms of aspects other than employment duration, due to its nature as a relational contract under the conditions of bounded rationality.

First, the LTER takes the form of a group contract, the contents of which are specified by the work rules (*shūgyō kisoku*), which generally apply to all workers in a firm.¹⁰³ In most developed countries, the outline of the rules of a firm is regulated by the minimum standards set by the

⁹⁵ See *supra* notes 87-88 and accompanying text.

⁹⁶ For the legal effect of invalid dismissals, see *supra* notes 85-86 and accompanying text.

⁹⁷ See ARAKI, *supra* note 20, at 27.

⁹⁸ See MINPŌ [Civ. C.], art. 1 para. 3.

⁹⁹ For the formation of doctrine of abusive dismissal, see Yamakawa, *supra* note 85, at 4-7.

¹⁰⁰ E.g., Saikō Saibansho [Sup. Ct.] Apr. 25, 1975, 29 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 456, 457-58 (Japan); Saikō Saibansho [Sup. Ct.] Jan. 31, 1977, 268 RŌDŌ HANREI 17, 18-19 (Japan).

¹⁰¹ Before the 2003 amendment, the Rōdō Kijinhō [Labor Standards Law], Law No. 49 of 1947, art. 18-2 provided: "A dismissal shall, where the dismissal lacks objectively reasonable grounds and is not considered to be appropriate in general societal terms, be treated as an abuse of that right and invalid." *Id.*, translated in LABOR STANDARDS ACT 13 (Japan Institute for Labour Policy and Training trans., 2003). For a brief summary of doctrine of abusive dismissal and 2003 amendment, see Nakakubo, *supra* note 80, at 13-18. For more on the new Employment Contract Act, see *infra* note 102.

¹⁰² Rōdō Keiyakuhō [Employment Contract Law], Law No. 128 of 2007, art. 16. This provision is identical to the former article 18-2 of Labor Standards Law that was deleted from Labor Standards Law according to the legislation of new Employment Contract Law. See *id.* at supplementary provision art. 2.

¹⁰³ See Rōdō Kijinhō [Labor Standards Law], Law No. 49 of 1947, arts. 89, 92-93; Rōdō Keiyakuhō [Employment Contract Law], Law No. 128 of 2007, art. 7.

collective bargaining at the industry level, and the co-determination system between employer and workers' council decides the details of the rules.¹⁰⁴

In Japan, the employer has the power to set the work rules¹⁰⁵ and this is the basic norm in the LTER. The Labor Standards Law requires every employer to frame work rules with regard to the main items¹⁰⁶ and to make them known to all workers.¹⁰⁷ The framing and the change of work rules must be submitted to the public agency known as the Labor Standards Inspection Office (*Rōdō Kijun Kantokusho*) so that they are supervised as being subject to the legal regulations and collective agreements among employers and workers.¹⁰⁸ As such, the work rules substantially govern the labor contract. It is therefore important for workers to reflect their opinions within its content.

Although it is obligatory for the employer to seek the workers' opinions in Japan,¹⁰⁹ it does not mean that employees (or union(s) of the firm) have veto power regarding changes in the work rules. If there is an agreement to change working conditions between workers and the employer, the changes will be effective.¹¹⁰ In principle, if the amendment of the work rule is against the workers' interest, it is necessary to gain the consent of the workers.¹¹¹ However, if an amendment is against the interest of workers, employers can unilaterally amend the work rules when the following two conditions are met.¹¹²

First, the workers must be informed of the amended work rules that reflect the change in working conditions.¹¹³ The second, and more important, condition is that the amendment of the work rules must be reasonable considering various factors, including the necessity of the

¹⁰⁴ See SUGENO, *supra* note 55, at 495-96.

¹⁰⁵ See *Rōdō Kijunhō* [Labor Standards Law], Law No. 49 of 1947, art. 90; *Rōdō Keiyakuhō* [Employment Contract Law], Law No. 128 of 2007, art. 7. See also SUGENO, *supra* note 55, at 115-19.

¹⁰⁶ *Rōdō Keiyakuhō* [Employment Contract Law], Law No. 128 of 2007, art. 11; *Rōdō Kijunhō* [Labor Standards Law], Law No. 49 of 1947, art. 89, paras. 1-10.

¹⁰⁷ *Rōdō Kijunhō* [Labor Standards Law], Law No. 49 of 1947, art. 106, para. 1; *Rōdō Kijunhō Shikō Kisoku* [Ordinance for Enforcing Labor Standards Law], Ministry of Health and Welfare Ordinance No. 23 of 1947, art. 52-2.

¹⁰⁸ See *Rōdō Keiyakuhō* [Employment Contract Law], Law No. 128 of 2007, art. 11; *Rōdō Kijunhō* [Labor Standards Law], Law No. 49 of 1947, arts. 89, 92, para. 2.

¹⁰⁹ *Rōdō Keiyakuhō* [Employment Contract Law], Law No. 128 of 2007, art. 11; *Rōdō Kijunhō* [Labor Standards Law], Law No. 49 of 1947, art. 90, para. 1.

¹¹⁰ See *Rōdō Keiyakuhō* [Employment Contract Law], Law No. 128 of 2007, art. 8.

¹¹¹ *Id.* at art. 9 (providing that except for the case where the conditions provided in article 10 of the Employment Contract Law are met, the workers cannot change the work rules against the interest of the workers unilaterally).

¹¹² *Id.* at art. 10.

¹¹³ *Id.*

changes in working conditions, extent of the disinterest workers will suffer, and the process of amendment.¹¹⁴ In reality, the work rules are framed and revised through negotiations with the labor union, since the implementation of these rules is impossible without the labor union's support.

Japanese employers are required to protect employment intensely because of both social norms and legal doctrines. In exchange, they gain discretion to set the work rules based on working conditions, personnel affairs, and enterprise order and discipline.

E. Working Conditions

Japanese labor law has avoided much intervention and given employers large discretion to control personnel matters and enterprise order and to discipline workers. This has been the basis for accumulating firm specific investments through OJT and other means in Japanese firms. The effects of the related laws are briefly summarized below.

First, firms have a freedom of recruitment, and Japanese employers have significantly more discretion in this aspect¹¹⁵ than those in the United States, wherein legislation on discrimination in the labor market is developed and thus discretion in hiring and recruitment is constrained.¹¹⁶ Although there are some restrictions on freedom at this stage in Japan,¹¹⁷

¹¹⁴ *Id.* This is based on the case law about the changing of work rules. See, e.g., Saikō Saibansho [Sup. Ct.] Dec. 25, 1968, 22 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 3459, 4363-64 (Japan) (indicating that change of the work rule must be reasonable and affirmed the change of the defendant corporation in order to introduce mandatory retirement age); Saikō Saibansho [Sup. Ct.] Feb. 28 1997, 51 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 705 (Japan) (in affirming the judgment of Tōkyō High Court, the Supreme Court held that the change of work rules which extends the mandatory retirement age of defendant bank from fifty-five to sixty but in turn reduces the wages is valid. In this case, before the work rules were changed, defendant bank had already hired employees between the ages of fifty-five and fifty-eight on conditions that were substantially similar to the working conditions just before the mandatory retirement, and therefore the change of work rules could be considerably disadvantageous to the employees. The court affirmed the change on the ground that the necessity of the change was so large, the wage after the change is still high compared to other firms, and the defendant bank's union had negotiated and agreed on the change). Article 10 of Labor Contract Law codified the summary of these case laws. See Takashi Muranaka, *Rōdō Keiyakuhō Seitei no Igi to Kadai [The Significance and Problems of the Legislation of Employment Contract Law]*, 1351 JURIST 42, 43-45 (2008). For the cases of work rule changes involving reduction of wages, see *infra* notes 123, 124 and accompanying text.

¹¹⁵ See, e.g., Saikō Saibansho [Sup. Ct.] Dec. 12, 1973, 27 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 1536, 1543-46 (Japan) (in remanding the case to Tōkyō High Court, the Supreme Court indicated that in principle, article 14 of the Constitution, which prohibits discriminatory treatment, does not restrict the discretion of firms in hiring and recruitment stage and thus investigating and asking about a job candidate's political ideology is not illegal).

¹¹⁶ See ARAKI, *supra* note 20, at 60-62.

¹¹⁷ For example, the Equal Employment Opportunity Law prohibits gender discrimination at the time of recruitment and hiring. Koyō no Bunya ni Okeru Danjo no Kintōna Kikai Oyobi Taigū no Kakuho ni

discriminatory treatments based on other features (e.g., political ideology) are not deemed void under the case law.¹¹⁸

Following recruitment, it is customary for Japanese firms to require active human capital investment by workers through OJT. The demand for OJT is linked with frequent rotations to train in various types of jobs. Employers have broad discretion regarding personnel reassignments, at least for typical workers whose work place or job type is not explicitly restricted by an employment contract.¹¹⁹ Sometimes, a worker opposed to a reassignment may be punitively dismissed. The law supports the system by admitting the employers' right to order and conduct OJT.¹²⁰ Note that giving employer's substantial discretion with regard to personnel affairs in itself does not directly lead to serious financial damages for employees since the Japanese wage payment system is not strongly associated with the type of job or location of the office.¹²¹

F. *Wage Payment*

With regard to the other aspects of working conditions, wage payment is clearly the most important matter. One legal restriction is the regulation of minimum wages.¹²² But for the wage payment system in the LTER, again, the autonomy of the management and laborers is broad.

During the Oil Shock and the 1990s recession, a drastic change in wage payment was often required for the survival of firms, and this unexpected change was frequently contested. The courts flexibly accepted this adjustment by considering the "reasonableness" of the revision of work

Kansuru Hōritsu [Equal Employment Opportunity Law], Law No. 113 of 1972, art. 5. *See supra* notes 75-79 and accompanying text. Also, imposing conditions on an applicant's age during recruitment is basically prohibited. *See* Koyō Taisakuho [Employment Countermeasures Act], Law No. 132 of 1966, art. 10.

¹¹⁸ *See supra* note 115. It is understood that employers have broader discretion in hiring and recruitment under Japanese law compared to the laws of the United States or the European Union. *See* YUICHIRO MIZUMACHI, RŌDŌHŌ [LABOR AND EMPLOYMENT LAW] 136-39 (3d. ed. 2010).

¹¹⁹ *See, e.g.*, Fukuoka Kōtō Saibansho [Fukuoka High Ct.] July 30, 1996, 757 RŌDO HANREI 21 (Japan) (finding that there was no restriction of job types for the plaintiff employee and therefore the reassignment was valid), *aff'd*, 757 RŌDO HANREI 20 (Sup. Ct., Sept. 10, 1998).

¹²⁰ *See* ARAKI, *supra* note 20, at 132-36.

¹²¹ *See supra* Part II.A.

¹²² In Japan, there are regional (for each prefecture) minimum wages and industrial minimum wages based on an investigation by the Minimum Wage Council (*Saitei Chingin Shinsakai*). *See* Saitei Chinginhō [Minimum Wage Law], Law No. 137 of 1959, art. 16 (Japan). Employers must, in principle, pay at least these minimum wages to workers, *see id.* at art. 5 para. 1, and the Labor Standards Inspector (*Rōdō Kijun Kantokukan*) has the authority to investigate, inspect, and question in order to ensure the performance of employer duties. *Id.* at art. 38.

rules on payment.¹²³ One basic rule is that employers may change the wage system, at least if it is judged indispensable to protect the employment of workers.¹²⁴

One significant rule which functions as a regulation on real wages in Japan after the late 1980s came from the regulation of working hours.¹²⁵ The Japanese Labor Standards Law that established the 48-hour work week system was substantially revised in 1987 and with gradual reduction of working hours, by 1997, the principle of the 40-hour work week was put completely into practice.¹²⁶ When employers require overtime or rest-day work, employers must make an agreement with the labor union (or the representative of majority of the employees in the office) and must file the agreement with the Labor Standards Inspection Office.¹²⁷ In addition, employers must pay a wage premium for such work.¹²⁸ Although it has been said that Japanese workers are overworked, working hours have continuously declined since the end of the 1980s because of the new legal regulations and the beginning of the recession.¹²⁹

¹²³ See Saikō Saibansho [Sup. Ct.] Dec. 25, 1968, 22 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 3459, 4363-64 (Japan); Saikō Saibansho [Sup. Ct.] Feb. 28 1997, 51 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 705 (Japan); Saikō Saibansho [Sup. Ct.] Sept. 7, 2000, 54 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] 2075 (Japan) (denying the effect of work rule amendment that resulted in the reduction of the wage for workers only who are above fifty-five). For the law on the change of work rules, see *supra* notes 104-114 and accompanying text.

¹²⁴ See, e.g., Ōsaka Chihō Saibansho [Ōsaka Dist. Ct.] May 28, 1997, 1641 RŌDŌ KEIZAI HANREI SOKUHŌ [RŌKEISOKU] 22 (Japan) (affirming the reduction of wage as part of reconstruction of defendant corporation, the court affirmed that there was no objection by plaintiff and the reduction was not against public policy. On the other hand, the court denied the effectiveness of cut of plaintiff's wage allegedly was due to the poor result of his job.) See also ARAKI, *supra* note 20, at 52-55. But in contrast to minor changes of work rules, it is not so easy to reduce the wage unilaterally. See, e.g., Saikō Saibansho [Sup. Ct.] Sept. 7, 2000, 54 SAIKŌ SAIBANSHO MINJI HANREISHŪ [MINSHŪ] at 2093-94.

¹²⁵ See generally SUGENO, *supra* note 55, at 259-60.

¹²⁶ See Rōdō Kijinhō [Labor Standards Law], Law No. 49 of 1947, art. 32, para. 1 (Japan) (providing that "an employer shall not have a worker work more than forty hours per week"). See also *id.* at art. 32, para. 2 (providing that "an employer shall not have a worker work more than eight hours per day for each day of the week").

¹²⁷ *Id.* at art. 36, para. 1.

¹²⁸ *Id.* at art. 37, paras. 1, 3.

¹²⁹ See KŌSEI RŌDŌSHŌ [MINISTRY OF HEALTH, LABOUR AND WELFARE], HEISEI 19 NEN-BAN KŌSEI RŌDŌ HAKUSHO SHIRYŌHEN [2007 WHITE PAPER ON WELFARE AND LABOR: DATA APPENDIX] 118 (2007) (Japan). In reality, it is very difficult to compare the working hours of different countries because of the difference of rules and the nature of statistics. As a reference, the White Paper on Welfare and Labor provides the data of the yearly working hours of the production workers in manufacturing in various countries in 2004. According to this data, workers in Japan and the United States work for approximately 1950 hours, those in the United Kingdom work for about 1900 hours, and those in France and Germany work for about 1530. *Id.* With regard to this data, the working hours of Japanese workers are still much higher than those of the workers in European countries. However, it is coming closer to the level of the United Kingdom and the United States. *Id.*

G. *Labor Unions and the Dispute Resolution System*

As the LTER is an incomplete contract, there is always a chance for dispute concerning contract interpretation. The following are the two types of dispute resolution systems: bargaining and negotiation organizations, and public agencies for the arbitration of the disputes.

In the former resolution system, the most important player is the labor union. The recent density of Japanese labor unions is below 20%.¹³⁰ This is much lower than the post-war rate of 50%.¹³¹ However, the density is higher than that in other developed countries such as France or the United States, wherein the union density is around 10%.¹³² Japanese labor unions are enterprise unions.¹³³ Though they often join an industrial federation of unions, industry-level collective bargaining is not common.¹³⁴ In the case of an industrial union, the negotiation aims at setting the criteria for generally regulating the labor conditions in the labor market. In contrast, Japanese labor-management negotiations mainly deal with intra-firm disputes.¹³⁵ In particular, after 1960, when the enterprise unions¹³⁶ began to establish the cooperative labor-management relationship and strengthened their management participation functions, Japanese labor unions grew closer in substance to the workers' council in Europe than to the European labor unions.

Japanese labor union law strongly protects the right of labor unions, reflecting a legislative intent immediately after the war to promote labor rights.¹³⁷ These rights consist of the right to organize, bargain collectively, and take collective action.¹³⁸ These days, explicit collective actions are rare, and collective bargaining has been replaced with more informal negotiations known as "labor-management consultation."¹³⁹ However, these rights of the

¹³⁰ See *id.* at 140.

¹³¹ *Id.*

¹³² Organization for Economic Co-operation and Development (OECD), OECD EMPLOYMENT OUTLOOK 2004 145 (2004).

¹³³ See SUGENO, *supra* note 55, at 500.

¹³⁴ See ARAKI, *supra* note 20, at 164.

¹³⁵ Note, however, that by using *Shuntō* (Spring Wage Offensive), labor unions also coordinate enterprise-level negotiations for the yearly increase in wage rates to a reasonable level, while adjusting it to the macroeconomic conditions of the year. See, e.g., REBICK, *supra* note 28, at 77-79.

¹³⁶ Even in small firms wherein labor unions do not exist, joint labor-management committees often exist; these committees perform the same role. See *id.* at 81-82.

¹³⁷ See Rōdō Kumiai-hō [Labor Union Law], Law No. 174 of 1949, art. 1 (Japan) (providing that the main aim of the Law is "to elevate the status of workers by promoting their equal standing with their employers in bargaining").

¹³⁸ See *id.* at art. 6.

¹³⁹ See ARAKI, *supra* note 20, at 179-80.

labor unions definitely hold the effect of a threat point in negotiations, and have served to promote the position of laborers.

Agreements between workers and employers formed through labor-management negotiations are either established as collective agreements (*rōdō kyouyaku*), which are superior to work rules,¹⁴⁰ or induce changes in the work rules.¹⁴¹

When the parties cannot resolve disputes themselves, public agencies engage in arbitration. In the case of collective disputes, the Labor Commissions (*Rōdō In kai*) intervene.¹⁴² Although it is a part of public administration, its members are chosen from the outside, such as academics or lawyers and representatives of unions and employers,¹⁴³ and its independence from the bureaucracy is guaranteed.¹⁴⁴ The basic principle of the Labor Relations Commission is to respect labor-management autonomy, so it usually does not compel resolution of disputes.¹⁴⁵ Though they order remedial measures to rectify the consequences of unfair labor practices, it has no prosecution division.¹⁴⁶ Owing to the development of the labor-management consultation system, the number of cases dealt with by the Commissions is diminishing.¹⁴⁷

Individual disputes may go on to civil litigation. As Japan does not have a special Labor Court, the disputes are treated as normal civil cases. The most important feature of individual disputes in Japan is the small number that are actually litigated: only 2000-3000 civil cases related to labor disputes are filed in the district courts every year.¹⁴⁸ This is in sharp contrast to European countries, such as France and Germany, where 160,000-600,000 cases are handled every year by the Labor Courts.¹⁴⁹

Japan's lower litigation rates, compared to other western countries, can be explained by high litigation costs due to the small number of lawyers and judges, and by the fact that systems promoting out of court agreements

¹⁴⁰ See *Rōdō Kijunhō* [Labor Standards Law], Law No. 49 of 1947, art. 92, para. 1 (Japan).

¹⁴¹ See SUGENO, *supra* note 55, at 114-15.

¹⁴² See *Rōdō Kumiai-hō* [Labor Union Law], Law No. 174 of 1949, art. 20 (Japan).

¹⁴³ *Id.* at art. 19, para. 1.

¹⁴⁴ See ARAKI, *supra* note 20, at 191-93.

¹⁴⁵ See SUGENO, *supra* note 55, at 673-74.

¹⁴⁶ See ARAKI, *supra* note 20, at 193-94.

¹⁴⁷ See KŌSEI RŌDŌSHŌ, *supra* note 129, at 140.

¹⁴⁸ See Saikō Saibansho Jimusōkyoku Gyōseikyoku [Administrative Affairs Bureau, Supreme Court], *Heisei 19-nendo Rōdō Kankei Minji, Gyōsei Jiken no Gaikyō* [Outline of Labor Relations Civil and Administrative Cases for 2007], 60 HŌSŌ JIHŌ 2421, 2447 (2008) (2246 cases were filed in 2007. From 1998 to 2007, 1708 to 2519 cases were filed each year).

¹⁴⁹ See *id.* at 375.

have developed.¹⁵⁰ In the case of labor disputes, labor-management consultations and administrative schemes to promote pre-trial agreements are particularly well developed.¹⁵¹ With the addition of high costs of litigation, everything possible is done to prevent disputes from going to court.

H. Labor Market Policy

Finally, it is worth looking briefly at the labor market policy in Japan. In addition to the Doctrine of Abusive Dismissal,¹⁵² other laws and policies dealing with the labor market also emphasize the protection of employment as its basic objective. For this purpose, the law explicitly states the need for active intervention by the government in the labor market.¹⁵³ In practice, the policies mentioned below are important.¹⁵⁴

First, private employment agencies had been strictly regulated.¹⁵⁵ Instead, Public Employment Security Office, a public agency, in principle, had monopolized placement and vocational guidance activities.¹⁵⁶ Second, unemployment benefits are provided to help unemployed workers.¹⁵⁷ Third, financial support is also offered to promote the employment of elders,¹⁵⁸ and handicapped people,¹⁵⁹ partly for the purpose of providing equal

¹⁵⁰ See J. Mark Ramseyer & Minoru Nakazato, *The Rational Litigant: Settlement Amounts and Verdict Rates in Japan*, 18 J. LEGAL STUD. 263 (1989). Haley first argued that the low number of court cases in Japan was due to institutional factors such as the low number of lawyers and judges, rather than using a cultural explanation. John O. Haley, *The Myth of the Reluctant Litigant*, 4 J. JAPANESE STUD. 359 (1978). For an analysis from a political perspective, see, e.g., Takao Tanase, *The Management of Disputes: Automobile Accident Compensation in Japan*, 24 L. & SOC. REV. 651 (1990). For a survey of related arguments and empirical analysis on factors behind increase in litigation in Japan, see Tom Ginsburg & Glenn Hoetker, *The Unreluctant Litigant?: An Empirical Analysis of Japan's Turn to Litigation* (Ill. L. & Econ. Working Papers Series, Working Paper No. LE04-009, 2004), available at <http://ssrn.com/abstract=608582>.

¹⁵¹ See *supra* notes 137-147 and accompanying text.

¹⁵² For the doctrine of abusive dismissal, see *supra* notes 84-102 and accompanying text.

¹⁵³ See Koyō Kankei Chōseihō [Employment Measures Law], Law No. 132 of 1966, arts. 1, 3-4 (Japan).

¹⁵⁴ For a survey of the Japanese law in the labor market, see SUGENO, *supra* note 55, at 31-73.

¹⁵⁵ See *supra* note 72.

¹⁵⁶ See Rōdō Kijunhō [Labor Standards Law], Law No. 49 of 1947, art. 6 (Japan).

¹⁵⁷ See generally Koyō Hokenhō [Employment Insurance Law], Law No. 116 of 1974 (Japan).

¹⁵⁸ See Koyō Hokenhō Shikōkisoku [Rule for Enforcement of Employment Insurance Law], Ministry of Labour Rule No. 3 of 1975, art. 104 (Japan) (providing subsidies for certain employment of elders). For a summary of Japanese Law concerning employment of elders, see Noboru Yamashita, *Act Concerning Stabilization of Employment of Older Persons*, 4(3) JAPAN LABOR REV. 71 (2007).

¹⁵⁹ In essence, the Law for Promotion of Employment of Handicapped People provides that if a firm's (only those that employ more than 300 employees) workforce is less than 1.8% handicapped, it will be required to pay penalties. See Shōgaisha no Koyō no Sokushintō ni Kansuru Hōritsu [Law for Promotion of Employment of Handicapped People], Law No. 123 of 1960, art. 53 (Japan); Shōgaisha no Koyō no

opportunities to workers. Fourth, the employment measures are designed to support depressed industries and areas.¹⁶⁰

As the list of policies above shows, the support to the unemployed people and the subsidization for the protection of employment constitute the main body of the policies, reflecting its objective of promoting employment security. Conventional wisdom of neoclassical economics categorizes the latter as the type of policy that simply preserves the inefficiency of the market, thereby impeding competition.¹⁶¹ After the 2000s, when firms began active employment adjustment, and the unemployment rate approached the 5% level,¹⁶² Japan's employment policy shifted its emphasis from protecting pre-existing employment to absorbing existing unemployment.¹⁶³ Drastic reform of the labor market law is now in progress, as will be shown in Part IV.B.

IV. ECONOMIC CONSEQUENCES OF THE JAPANESE LEGAL POLICY ON LABOR RELATIONS

A. *The Relationship Between Labor Relations and Labor Law in Japan*

The JEC and Japanese labor law developed in parallel after World War II. Is it then possible to state that the Japanese labor law enforced the establishment of JEC? As the basic principles of Japanese labor law suggest, the legal system and its principles were influenced by Western society, particularly the United States, after World War II.¹⁶⁴ Therefore, it is difficult to say that those laws enacted through the reform after World War II themselves established the development of the JEC, which characterized the post-war Japanese employment system.

Furthermore, Japanese labor law at least in part respects the autonomy of labor and management by establishing only a basic framework concerning

Sokushintō ni Kansuru Hōritsu Shikōrei [Ordinance for Enforcement of Law for Promotion of Employment of Handicapped People], Ordinance No. 292 of 1960, art. 18 (Japan). In contrast, a firm receives subsidies if it surpasses the 1.8% quota of handicapped workers. See Shōgaisha no Koyō no Sokushintō ni Kansuru Hōritsu [Law for Promotion of Employment of Handicapped People], Law No. 123 of 1960, arts. 49-50 (Japan).

¹⁶⁰ For the present situation concerning regional employment, see Minoru Itō, *Measures for Supporting Regional Job Creation in Japan*, 5(1) JAPAN LABOR REV. 85, 92-99 (2008).

¹⁶¹ See, e.g., HARVEY S. ROSEN, PUBLIC FINANCE 303-10 (2d ed. 1988) (arguing that subsidies and differential tax treatment among production factors create deadweight losses to the overall economy).

¹⁶² See Ministry of Health, Labour and Welfare, *Employment and Unemployment Trends*, WHITE PAPER ON THE LABOUR ECONOMY 2005 3-4 (2005), <http://www.mhlw.go.jp/english/wp/l-economy/2005/dl/01-01.pdf>.

¹⁶³ See ARAKI, *supra* note 20, at 31-32.

¹⁶⁴ See GOULD, *supra* note 30, at 106-16.

industrial relations. There are not many laws that enforce or even point toward the JEC, and hence, it can be said that the labor laws only set the frame and the base of the autonomous negotiation, under which the LTER had been developed spontaneously. In other words, labor laws somewhat restricted party freedom to contract by setting the minimum standards, or by regulating negotiation methods, but the LTER is something that emerged within that restriction as a set of contracts (in the economical sense). This observation corresponds with our theoretical conclusion concerning the JEC in Part II.B. that the LTER in Japan can be regarded as an implicit contract, which continues for a long period and which is self-binding between employers and employees.

In summary, the Japanese legal system has made important contributions as a sub-system to the social enforcement of the JEC merely through setting a reasonable stage for the mutual agreement between labor and management. With protection of the right of workers and the autonomy of parties guaranteed by the legal framework, labor and management autonomously adopted the system of JEC as a type of implicit contract in post-war Japan.

It may be noteworthy to mention a covert but important legal aspect for the establishment of the JEC. The Japanese legal system for minimizing individual labor disputes has greatly contributed to efficient management by decreasing dispute costs to firms and protecting their power of discretion. At the same time, however, it seems that the high cost of litigation and the social pressure for pretrial agreements have made it difficult to bring lawsuits.¹⁶⁵ It has been argued that a new system of individual dispute resolution, which is more accessible to individual workers, should be organized.¹⁶⁶

B. Adjustment of Labor Relations and Labor Law to the Structural Change of the Economy After the 1990s

Following the 1990s, the merit of the JEC diminished because of active technological innovations. Firms were required to shed unwanted labor to cope with the long-run macroeconomic stagnation. Therefore, it

¹⁶⁵ See Kazuo Sugeno, *Judicial Reform and the Reform of the Labor Dispute Resolution System*, 3(1) JAPAN LABOR REV. 4, 5-6 (2006) (providing information on the low level of labor litigation in Japan).

¹⁶⁶ See, e.g., *id.* at 8-12 (discussing the need for reform of the system for resolving individual labor disputes). For labor tribunal system under Labor Tribunal Law (*Rōdō Shinpanhō*) of 2004, see Katsutoshi Kezuka, *Significance and Tasks involved in Establishment of a Labor Tribunal System*, 3(1) JAPAN LABOR REV. 13, 16-27 (2006).

was necessary to restructure the existing industries and develop new industries that embodied new technologies by using the market mechanism, including the migration of the labor force from old to new businesses and industries. Rich empirical literature exists documenting the United States labor markets' polarization of high and low-wage jobs induced from skill-based technical changes; this is also the case in Japan.¹⁶⁷ This tendency for the polarization of the labor market in Japan can be an indirect but persuasive empirical basis for the change of labor demand for the Japanese firms and the relative decline of the importance of the firm-specific skills.

As shown below, while in some areas of the labor law this reform was actually put into effect, the regulation of labor relations and the labor market has been tightened in other areas, leading to the aggravation of distortionary effects on the economy. This section discusses first the competition-promoting change and the next section discusses the efficiency-decreasing regulations.

The reform of the JEC by law was first put into practice by using its flexible legal structure. As pointed out in the previous section, Japanese labor law does not reinforce or even push in the direction of an LTER as the typical employment relation in Japan. It allows for various types of labor contracts. In effect, more specific and individualized contracts than the LTER are allowed in present Japan. The Japanese wage payment system based on seniority is also being reformed to reflect performance measures more directly¹⁶⁸ and workers are willing to accept these changes.¹⁶⁹ This change allows for richer options for workers and will be efficiency enhancing in the present economic environment, where technical progress, and the diversification of labor force to include female workers, middle-aged and older workers, and foreigners deepen rapidly.

In the area of labor market law, more explicit reforms are currently in progress. To cope with the rapid change in the economic environment, Japanese labor law has recently begun to emphasize the activation of the external labor market by the deregulation of the private employment agency

¹⁶⁷ See, e.g., David H. Autor, *The Polarization of the U.S. Labor Market*, 96 AM. ECON. REV. 189 (2006). For the labor market in Japan, see Toshie Ikenaga, *Rōdō Shijō no Nikyokuka: IT Gyōmu no Dōnyū to Gyōmu Naiyō no Henka ni Tsuite* [Polarization of the Japanese Labor Market: Adoption of ICT and Changes in Tasks Required], NIHON RŌDŌ KENKYŪ ZASSHI, No. 584, at 73 (2009) (showing similar polarization in the Japanese labor market during 1980-2005).

¹⁶⁸ See KŌSEI RŌDŌSHŌ [MINISTRY OF HEALTH, LABOUR AND WELFARE], HEISEI 19NEN-BAN RŌDŌ KEIZAI NO BUNSEKI [ANALYSIS OF LABOR ECONOMICS 2007] 105-08 (2007) (indicating that making wage more reactive to worker performance has become popular).

¹⁶⁹ See ARAKI, *supra* note 20, at 70-73.

business and public support to the vocational training provided to the unemployed.¹⁷⁰ The law for subsidizing employment in depressed industries has been abolished¹⁷¹ and instead a subsidization policy related to newly created industries such as those pertaining to information, environment, medicine, and welfare industries was implemented.¹⁷² At the same time, unemployment benefits are enhanced in order to provide a safety net to cope with increasing unemployment.

It can be said that the present employment policy in Japan not only uses the JEC to protect employment but also supports the adjustment ability of the external labor market mechanism and tries to integrate these two previously distinct policies to establish full employment.

C. *Potential Sources of Economic Distortion by Legal Regulations on Japanese Labor Relations*

In some other areas, the direction of present Japanese labor law emphasizes the direct regulation of the labor relations rather than respecting their autonomy.

First, the regulation of wages is likely to reduce the efficiency of the economy. One such direct legal restriction is the minimum wage legislation,¹⁷³ wherein a considerable amount of resource allocation waste has been created for allocating labor for small business and part-time workers.¹⁷⁴ With respect to workers covered in the LTER, a more significant regulation of real wages was the result of the reduction in working hours. According to recent influential empirical research, some significant part of the slowdown of the Japanese economy in 1990s can be explained by this

¹⁷⁰ See KŌSEI RŌDŌSHŌ, *supra* note 129, at 223-28 (explaining measures for vocational training).

¹⁷¹ Tokutei Fukyō Gyōshutō Kankei Rōdōsha no Kōyō no Antei ni Kansuru Tokubetsu Sochihō [Law on Special Measures Concerning the Stabilization of Employment in Specified Depressed Industries], Law No. 39 of 1983 (Japan) was abolished in 2001. This abolition was a part of reform of the labor market law in 2001 which in turn was in line with the deregulation policy of Japan after bubble economy.

¹⁷² Kōyō Taisakuhō [Employment Measure Law], Law No. 132 of 1966 (Japan) was amended. This amendment was also a part of the reforms of 2001. See KAZUO SUGENO, SHIN-KOYŌ SHAKAI NO HŌ [EMPLOYMENT SYSTEM AND LABOR LAW] 88-93 (Supplemented ed. 2004). For more information on the reform of regional employment laws, see Itō, *supra* note 160, at 88-91 (explaining policy and legal changes concerning regional employment after 2000).

¹⁷³ For law regarding minimum wages, see *supra* note 122 and accompanying text.

¹⁷⁴ See RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 322-55 (7th ed. 2007) (discussing the welfare implications of the legal regulation of the minimum wage).

regulation.¹⁷⁵ So it is difficult to justify further regulations to shorten work hours from the viewpoint of efficiency.

Let us consider the economic effects of the Japanese employment security more in-depth. First, consider the effect on the allocation of labor among various firms and industries, and second, the effect on the accumulation of firm-specific human capital. Under the frictionless neoclassical competitive labor market, the effect on the allocation of labor is neutral to resource allocation including the unemployment rate, since the strict protection of workers is completely offset by the reduction of wage rates.¹⁷⁶ However, it is sometimes difficult to make such adjustment smoothly. For example, when firms require rapid restructuring because of the unexpected change of the economic environment, firms are usually constrained by labor law not to make drastic reduction of wages. In such cases, firms are required to hire unwanted high-cost labor so that the allocation of labor should be distorted by the employment protection.

Next, considering the effect on firm-specific human capital, there is a widespread belief that employment protection enhances the incentive of workers to make such investment.¹⁷⁷ As long as the development of firm-specific human capital is unverifiable to the courts, a worker will make less firm-specific investment anticipating opportunistic behavior by an employer. If so, the employment protection by law may enhance efficiency by deterring an employer from betraying the worker who made sufficient firm-specific investment.¹⁷⁸ But in reality, workers protected by the employment protection law have no incentive to make such an effort, since their job is legally protected without any effort.¹⁷⁹ So, punishment was necessary for the workers who did not accumulate firm-specific human capital.

¹⁷⁵ See Fumio Hayashi & Edward C. Prescott, *The 1990s in Japan: A Lost Decade*, 5 REV. ECON. DYNAMICS 206 (2002) (suggesting that the strengthened legal restrictions on working hours significantly contributed to the slowdown of the macroeconomic performance of the Japanese economy in the 1990s).

¹⁷⁶ See Edward P. Lazear, *Employment-at-will, Job Security, and Work Incentives*, in EMPLOYMENT, UNEMPLOYMENT AND LABOR UTILIZATION 39, 46-52 (Robert A. Hart ed., 1988).

¹⁷⁷ See, e.g., Hiroyuki Chuma, “*Kaikoken Ranyō Hōri*” no *Keizai Bunseki* [Economic Analysis of the “Doctrine of Abusive Dismissal”], in KAISHAHŌ NO KEIZAIGAKU [THE ECONOMICS OF CORPORATE LAW] 425, 444-50 (Yoshiro Miwa et al. eds., 1998).

¹⁷⁸ For pros and cons of the laws restricting dismissal, see Takashi Araki & Fumio Ōtake, *Kaiko Kisei* [Regulations on Dismissals], in KOYŌ SHAKAI NO HŌ TO KEIZAI [LAW AND ECONOMICS IN LABOR AND EMPLOYMENT RELATIONS] 4, 15-24 (Takashi Araki et al. eds., 2008). Employment protection is sometimes justified from viewpoints other than economic efficiency, such as protection of civil rights or fairness. While we do not deny values other than economic efficiency, it should be noted that protecting existing workers from dismissal might be attained only at the cost of potential workers who do not yet have jobs. See *id.* at 19.

¹⁷⁹ See Lazear, *supra* note 176, at 54-56.

In the absence of a method other than dismissal for this punishment, it is true that employment protection destroys that innate efficiency in the JEC discussed in Part II.B. However, it is possible to punish the workers by a reduction in wages, demotion, or by suspending the employee's expected promotion. In this case, the employment protection policy is again neutral to resource allocation. In other words, if we are to maintain the employment protection in the form of restricting dismissals, we need to give employers some means other than dismissal in order to offset the shortcoming of the regulation. As discussed above, the regulations on working conditions have been strengthened since the 1980s.¹⁸⁰ In view of these extended limitations on the discipline of workers, tight employment protection is more likely to be a factor in diminishing the efficiency of the Japanese labor relations in the accumulation of firm-specific human skills. This is because those regulations may distort distributions of resources by raising costs of disciplining and reassignment of workers. Also, this makes it difficult for Japanese firms to move workers from obsolete industries to growing ones. In a time of rapid change in technology and economic structures, these costs are not small. Even when a law does not change the actions of employers substantially, it nevertheless may impose costs because employers make efforts to circumvent the regulations. So together with economic situations in the 1990s some of the labor law reforms led to economic inefficiency.

All in all, the overall development of regulations on working conditions and employment seems to have made it more difficult for firms to restructure, and for labor market to allocate labor force among various industrial sectors more appropriately, impeded the accumulation of new skills of workers, and barred new industries from entering the market due to the increase in labor cost. As its consequence, more unemployment and the substitution of regular workers with part-time workers occurred, particularly in the younger generation. With regard to this it is understood that "*freeters*" are not simply a continuation of the system of non-regular workers, but are a product of the recession in the 1990s. Though the recession itself was caused by macroeconomic fluctuation that is not related with employment custom or labor law, the stagnation hit younger workers disproportionately

¹⁸⁰ We do not regard reforms of regulations against sexual discrimination at the stage of hiring forced Japanese firms to hire unwanted female workers. When Equal Employment Opportunity Law was amended in 1997 to mandate equal treatment at the employment stage, the employment rate of women in Japan had already been increasing. In this case, the law reflected the reality and adapted to it rather than changing it. For the backgrounds of amendment, see Yamakawa, *supra* note 24, at 637.

because of strict employment protection regulations.¹⁸¹ In this sense, labor law matters to the “*freeter*” phenomenon.

Main empirical research on the effect of employment protection on labor market performance has confirmed that employment protection causes a negative effect on the labor market.¹⁸² Given these empirical contributions, it seems to us that the strengthening of the employment security that developed after the 1970s in Japan caused welfare loss to the Japanese economy.

D. *Changing JEC in Broader Contexts of Japanese System*

In recent Japan, it is argued that not only JEC but also other traditional features such as cross shareholdings, *keiretsu* and main bank system are under change.¹⁸³ Although this article does not deal with those features themselves, they are briefly mentioned.

First, some empirical research shows that changes in other aspects have led to changes in employment customs.¹⁸⁴ As long as this holds, changes in JEC are accelerated by complementarity among institutions.

Second, there have been arguments on whether Japanese system is totally changing or not.¹⁸⁵ Although it is difficult to conclude decisively at this moment, it is important to understand that JEC is gradually adjusting to changing economic environments. As indirectly indicated in the fact that

¹⁸¹ See OECD, *supra* note 132, at 76-88.

¹⁸² See, e.g., Edward P. Lazear, *Job Security Provisions and Employment*, 105 Q.J. ECON. 699, 706-17 (1990) (empirically showing that the employment protection policy not only increases unemployment but also creates the tendency to replace the permanent positions of workers with part-time workers.); James Heckman & Carmen Pages-Serra, *The Cost of Job Security Regulation: Evidence from Latin American Labor Markets*, 1 ECONOMIA 109 (2000) (empirically showing that employment regulation decreases the employment rate, especially for the younger generation).

¹⁸³ Recent discussions are collected in CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY (Masahiko Aoki et al. eds., 2008). But Miwa and Ramseyer cast doubt on the existence of those features. See *supra* note 2.

¹⁸⁴ See, e.g., TAKEO HOSHI & ANIL KASHAP, CORPORATE FINANCING AND GOVERNANCE IN JAPAN: THE ROAD TO THE FUTURE (2001); Masahiro Abe, *Corporate Governance Structure and Employment Adjustment in Japan: An Empirical Analysis Using Corporate Finance Data*, 41 IND. REL. 683, 698-99 (2002) (indicating correlation of shareholdings and speed of labor adjustment); Masahiro Abe & Takeo Hoshi, *Corporate Finance and Human Resource Management in Japan*, in CORPORATE GOVERNANCE IN JAPAN: INSTITUTIONAL CHANGE AND ORGANIZATIONAL DIVERSITY 257, 272-79 (Masahiko Aoki et al. eds., 2008) (indicating correlation between shareholding structures and existence of features of traditional Japanese employment customs).

¹⁸⁵ On the one hand, it is argued that corporate governance including employment system in Japan is moving toward the United States model. See, e.g., Takashi Araki, *A Comparative Analysis: Corporate Governance and Labor and Employment Relations in Japan*, 22 COMP. LABOR L. & POL'Y J. 101 (2000). On the other hand, there is an argument that Japanese system, including corporate governance, has not changed fundamentally. See, e.g., Haley, *supra* note 18.

labor market in Japan is polarizing,¹⁸⁶ firm specific skill is becoming less important. Therefore, long- term employment may well decrease, but not disappear, reflecting this change.

V. CONCLUSION

This article discussed the functions of the Japanese labor law in relation to the Japanese system of labor relations, which is referred to as the JEC. This article first described and analyzed the characteristics of the JEC. In the LTER that prevails in Japan, workers must follow orders from the employer with respect to OJT and other personnel affairs, enterprise order and discipline. Employers are, in turn, committed to the permanent employment of workers and appropriate payment of wages for their efforts, without depending on the managerial environment. This efficient outcome is characterized by a high level of accumulation of firm-specific intellectual skills and low unemployment.

Since this system is in principle realized as a self-enforcing social equilibrium, it is not enforced directly through the Japanese labor law. However, in several aspects, the Japanese labor law has served as a subsystem to support this efficient social equilibrium. First, Japanese employers are, by law, allowed more discretionary freedom for controlling laborers than the employers in the West. This facilitated the capability of employers to reassign workers and increase investment in firm-specific skills through OJT. The limited access of workers to litigation also served to protect this system. Second, labor-management autonomy remains broad with regard to dispute resolution, so that legal regulation and arbitration are not actively pursued. This principle made it possible to realize the efficient reputation equilibrium through the long-term relationship between unions and employers.

At present, it is unclear whether the JEC will prevail in the future. If it is not the case, one possibility is that Japanese firms may not protect this custom by reneging on the payment of the workers' effort, pursuing short-run profit. Then, the JEC will be transformed into a neo-classical competitive market system. It might be the case that the labor market allocation of human resource may be even superior to that by an internal labor market in the present economy, since firm-specific human capital is relatively less important in the present economic situation. If this is the case, this transition is favorable for the efficiency of the overall economy. In this

¹⁸⁶ See *supra* note 167 and accompanying text.

case, however, appropriate legal measures should be considered as a safety net for workers who belonged to the LTER but were reneged on the payment for their efforts.

Another possibility is that Japanese workers may demand more comfortable working conditions, while protecting the legal regulations on employment security. In this case, Japanese employment society might converge to an economy with lower productivity and a higher unemployment rate especially for young generations.

In any case, as long as the JEC is the product of the labor-management autonomy, which was not directly enforced through law, it is unlikely for the law to have a decisive power for its protection in the future. However, it is important that the law should not have a negative efficiency effect through inappropriate legal intervention in labor relations. For the sake of efficiency, it is much more reasonable to leave much room for the individual agreement between workers and employers. At the same time, employment security measures should not be chosen to preserve the unproductive sector of the economy, impede the development of new and productive industries, and to rescue unwanted or unmotivated workers. Given the need to extend the regulation on the working conditions, particularly with respect to equal opportunity policies for sexes, ages, nationalities, and rapid technical innovation, the relaxation of the protection of employees is necessary for the discipline of laborers and sectorial adjustment in Japanese employment society in the near future.